DEFENSE APPROPRIATIONS/Defense Contractor Restructuring Costs

SUBJECT: **Department of Defense Appropriations Bill for fiscal year 1998 . . . S. 1005. Harkin amendment No. 848.**

ACTION: AMENDMENT REJECTED, 15-83

SYNOPSIS: As passed, S. 1005, the Department of Defense Appropriations Bill for fiscal year 1998, will appropriate $247.2 billion for the military functions of the Department of Defense for fiscal year (FY) 1998, which is $$3.25 billion more than requested and $3.1 billion more than provided in FY 1997; funding will be $1.2 billion below the authorized amount. Details are provided below.

The Harkin amendment would bar the use of funds from this Act to pay costs incurred by a defense contractor when it merged with another business. The amendment would apply to merger costs that were incurred on or after July 15, 1997.

Those favoring the amendment contended:

Prior to July 1993, the Defense Department had a longstanding practice of not permitting defense contractors to charge restructuring costs to flexibly priced contracts that were transferred from one contractor to another as a result of a business combination. The rationale behind that policy, with which we agreed, was that the taxpayers should not have to pay higher prices on defense contracts for costs that had nothing to do with those contracts; if businesses decided that it was in their economic interests to combine, they were free to do so and assume the costs of combining, but they had no right to stick the taxpayers with the bill. In 1993, then-Under Secretary of Defense for Procurement Deutch unilaterally announced that the Defense Department would pay merger costs. No laws or regulations were changed. Under Secretary Deutch said that no laws or regulations had to be changed because he was not changing a policy; he was merely explaining existing law. If it is true that existing law allows the Government to be billed for merger costs, then the United States is subject to enormous liabilities from prior defense, and nondefense, contracts on which it did not pay such costs. If it is not true, then Under Secretary Deutch did not follow the required procedures for making changes to the Federal Acquisition Regulations.

(See other side)

YEAS (15)

Republicans (2 or 4%)	Democrats (13 or 29%)
Grassley	Boxer
Thompson	Bumpers
	Byrd
	Dorgan
	Durbin
	Feingold
	Glenn
	Harkin
	Kohl
	Moynihan
	Torricelli
	Wellstone
	Wyden

NAYS (83)

Republicans (51 or 96%)		Democrats (32 or 71%)	
Abraham	Hutchison	Akaka	Kennedy
Allard	Inhofe	Baucus	Kerrey
Ashcroft	Jeffords	Biden	Kerry
Bennett	Kempthorne	Bingaman	Landrieu
Bond	Kyl	Breaux	Lautenberg
Brownback	Lott	Bryan	Leahy
Campbell	Lugar	Cleland	Levin
Coats	Mack	Conrad	Lieberman
Cochran	McCain	Daschle	Mikulski
Collins	McConnell	Dodd	Moseley-Braun
Coverdell	Murkowski	Feinstein	Murray
Craig	Nickles	Ford	Reed
D'Amato	Roberts	Graham	Reid
DeWine	Roth	Hollings	Robb
Domenici	Santorum	Inouye	Rockefeller
Enzi	Sessions	Johnson	Sarbanes
Faircloth	Shelby		
Frist	Smith, Bob		
Gorton	Smith, Gordon		
Gramm	Snowe		
Grams	Specter		
Gregg	Stevens		
Hagel	Thomas		
Hatch	Thurmond		
Helms	Warner		
Hutchinson			

NOT VOTING (2)

Republicans (2)	Democrats (0)
Burns-[2]	
Chafee-[2]	

EXPLANATION OF ABSENCE:
1—Official Business
2—Necessarily Absent
3—Illness
4—Other

SYMBOLS:
AY—Announced Yea
AN—Announced Nay
PY—Paired Yea
PN—Paired Nay

We believe that regardless of the legality of the Under Secretary's decision, Congress should act to reverse it. Our colleagues disagree; they argue that defense contractors need to be encouraged to merge as a means of preserving our defense industrial base as our procurement budget shrinks. Their argument would carry more weight with us if there were any evidence that defense contractors needed encouragement to merge, or if there were any evidence that they were in difficult financial shape. Instead, what we have seen in recent years is defense contractors posting record profits, and we have also seen mergers of large companies. We are aware that current law, and this bill, do not allow the Government to pay merger costs unless it can be shown that the merger in question will result in a net benefit for the taxpayers. However, we are also aware that the General Accounting Office (GAO) has looked at this issue and said that it is only possible to estimate savings--they cannot be proven. Estimated savings mostly come from cost avoidances, such as from firing people, and are estimated by looking several years in advance and assuming other conditions remain static. Other conditions never remain static, so actual savings can never be proven. Thus, any company lucky enough to hold a Federal defense contract that wants to merge with another company can come up with an unprovable estimate that the taxpayers should have to pay part of the costs.

The bottom line is still that businesses are going to merge if it is in their interests to do so. They are not going to run away from greater profits, nor are they foolishly going to refuse to merge when necessary to avoid bankruptcy, nor are they ever going to avoid acting in their own financial interests. They do not need the extra incentive of free money from the Federal Government for them to make rational business decisions. The Harkin amendment would take away that wasteful extra incentive. We urge our colleagues to support this amendment.

Those opposing the amendment contended:

Our colleagues have two concerns. First, they believe that the taxpayers are losing funds as a result of defense industry mergers. Second, they believe that these mergers are resulting in a net loss in employment. They are totally wrong on the first count, and they are wrong in the long term on the second. The amendment they have proposed to solve the nonexistent problems with Federal payments of merger costs would weaken national security and in the long run would increase unemployment.

The first point of which Senators should be aware is that last year's bill, and this year's bill as well, only will allow restructuring costs to be paid if "the auditable savings for the Department of Defense resulting from restructuring will exceed the costs allowed by a factor of at least two to one" or "the savings from the Department of Defense resulting from restructuring will exceed the costs allowed and the Secretary of Defense determines that the business combination will result in the preservation of a critical capability that might otherwise be lost." In other words, the Defense Department will only pay merger costs if doing so will end up with it saving at least twice as much as it spends or if failing to do so will end up with a company going broke before completing a contract and leaving no other American company with the expertise to finish it. Additionally, only legitimate costs will be reimbursed--under no circumstances will the Federal Government pay for any merger bonuses to individuals.

To us, this policy sounds very sensible. Procurement of defense items has gone down by more than 60 percent in the past few years, and, despite our colleagues' assurances that the remaining companies of course have just combined, we have seen our country's industrial capabilities diminish rapidly, and we have seen many concerns go out of business. Our defense industry is being left to scramble for sales in the increasingly competitive world market. If our companies are large enough and efficient enough to compete in the world market, the United States will be able to preserve its defense industrial base plus it will be able to purchase items at lower cost.

The alternative, as proposed by the Harkin amendment, would be to prohibit the United States from paying for mergers, which would effectively stop some mergers from taking place. To the extent that companies failed to combine, they would not be able to cut operating costs. In the short term, the United States would have to pay more for defense items, and would thus not be able to purchase as much. National security would be weakened. Jobs would be saved in the short term, however. In effect, the Harkin amendment would force the subsidization of defense industry jobs at the expense of national security. In the long term, the subsidization effect would disappear. Smaller, inefficient defense firms would gradually lose their ability to compete in the world market. As they lost their world customers, their prices for the United States Government would commensurately increase, forcing it to cut back further on procurement, which would then cause layoffs and bankruptcies. In the long term, the Harkin amendment's attempt to subsidize defense industry jobs would backfire; the United States would lose both those jobs and its defense industrial base.

We do not like the fact that restructuring in the defense industry causes jobs to be lost. However, for national security reasons, that restructuring needs to be encouraged. In the long run, it will contribute to the health of the industry. The current policy that encourages mergers is good for the taxpayers, good for national security, and good for defense workers. The Harkin amendment would repeal the current policy. Clearly this amendment should be rejected.